

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

PERIODIC REPORTING
(PROPOSAL EIGHT)

Docket No. RM2017-12

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
REGARDING PROPOSAL EIGHT
(September 26, 2017)

Pursuant to Commission Order No. 4025 (August 2, 2017), comments regarding Proposal Eight were to be submitted no later than September 18, 2017. Having by separate motion dated today requested leave to respond, the Postal Service hereby submits its reply comments addressing the comments of the Alliance of Nonprofit Mailers (ANM) filed on that date.¹ Upon careful examination of all of the comments received, the Commission should move forward with the approval of Proposal Eight.

ANM begins the argument section of its comments by mischaracterizing the essence of Proposal Eight:

In 2008, after the enactment of the PAEA led to the elimination of rate subclasses, the USPS persuaded mailers and the Commission that implementing the 60 percent ratio as closely as practicable required applying the ratio to nonprofit Standard Mail as a whole vis-à-vis commercial Standard Mail as a whole. Now, nine years and many rate increases later, the Postal Service contends that the statutory interpretation it persuaded the Commission to adopt in 2008 violates Section 3626(a)(6), and the interpretation that the Postal Service rejected in 2008 is required after all. The Commission should reject this interpretive somersault.

¹ Responsive materials were submitted by numerous entities on, before, and after September 18th, but many of those were pro forma, and none of the other submissions opposing Proposal Eight contained arguments or issues beyond those addressed in the much more comprehensive ANM pleading. Therefore, reply comments specifically addressing ANM's filing implicitly respond to the other submissions as well, to the extent that any response to those materials might be warranted.

ANM Comments at 12. There are several erroneous aspects of this summary. First, as quoted by ANM itself three pages earlier in its comments, the Postal Service in Docket No. R2008-1 indicated merely its intent to apply the standard at the overall class level, but made no representation, let alone any attempt to “persuade,” that such an approach was “required.” Second, nowhere in Proposal Eight has the Postal Service indicated that continued application of the standard at the overall class level would “violate” the statute. Third, nowhere in Proposal Eight has the Postal Service indicated that its preferred return to application of the standard at the subclass level “is required after all.” What the Postal Service actually said to explain Proposal Eight is much more measured:

The Postal Service proposes to return to its pre-PAEA (i.e., PRA) convention of applying Public Law 106-384’s 60 percent rule to USPS Marketing Mail Regular and USPS Marketing Mail Enhanced Carrier Route separately. This is consistent with the language of the statute and is in accord with the pre-PAEA subclass definitions.

Proposal Eight at 5.

It is not surprising that ANM failed to challenge the actual justification offered by the Postal Service. First, it would be impossible to contend that the language of section 3626(a)(6) does not specifically reference subclasses, and therefore equally impossible to contend that what the Postal Service proposes would be inconsistent with the language of the statute. Second, the contours of the pre-PAEA subclasses remain plainly applicable, and ANM does not even bother to assert that the specific bifurcation

of existing products into the two “subclass” categories proposed by the Postal Service creates issues or concerns.²

What the Postal Service is doing in Proposal Eight is nothing more than requesting, in an entirely transparent manner, that the Commission change course and revert to the pre-PAEA application of the 60 percent ratio at the subclass level. The very cases that ANM cites on pages 12-13 of its comments, and many similar cases, make clear that an agency may make such a departure from past practice, as long as it acknowledges that it is making a change, and provides a reasoned basis for doing so. The grounds offered by the Postal Service in advancing and defending Proposal Eight, if adopted by the Commission, would constitute such a reasoned basis for the reversion to past practice. As demonstrated next, ANM is simply in error when claiming, on page 13, that the Postal Service has provided no reasoned basis for the change. There are ample reasons.

² ANM instead makes the strained argument that the ability to make changes in “classifications, mail preparation requirements and rate designs” could cause mail to shift between products (and thus potentially between “subclass” categories if the products in question happen to fall on different sides of the “subclass” divide), and that such circumstances would create the opportunity for “manipulation” of the 60 percent ratios. ANM Comments at 17. It is theoretically true that such classification evolution could affect the calculation of the nonprofit ratio for the respective “subclass” categories, but it is incorrect to further suggest that the Postal Service has any practical incentive to undertake the burden of classification changes merely to manipulate those ratios, particularly in the price cap environment. Moreover, the possibility of classification changes moving mail pieces on the margin from one subclass to another (and thus possibly affecting subclass ratio calculations) is inherent in any regime with subclasses, whether they be the historic DMCS subclasses or new so-called “pseudo-subclasses,” and yet, as just noted, the actual statutory language plainly contemplates ratios calculated at the subclass level. Consequently, this argument is nothing more than an expression of dissatisfaction with the statute as enacted in 2000, rather than a bona fide challenge to the actual Proposal Eight division of existing products into the two “subclass” categories.

To begin this discussion, however, it is important to correct the mischaracterization that ANM has presented of the “primary justification” motivating the Postal Service’s request – “that applying the 60 percent ratio to Marketing Mail as a whole produces lower nonprofit rates than does applying the 60 percent ratio separately to regular and ECR mail.” ANM Comments at 13 (emphasis added). More accurately stated, the fundamental problem with the existing approach is that it produces different nonprofit rates. In other words, what the ANM characterization misses is that the Postal Service would be equally motivated to make this proposal if the mail mix relationships were reversed and the current approach produced correspondingly higher nonprofit rates. It is the existence of a material and persistent discrepancy between the results of the current method and the previous method that motivates the proposal, *not the direction of that discrepancy*.

ANM, however, seeks to emphasize the fact that, had anyone looked, the data would have revealed the existence of such a discrepancy even in the years prior to the announcement by the Postal Service in February of 2008 that the 60 percent rule had been applied at the class level in designing the rates set forth in the R2008-1 Notice. ANM Comments at 13-15. While true, that does not prove that anyone actually was making the comparison at that time.³ More importantly, this argument does not give due recognition to the plethora of activities in which the Postal Service, the Commission, and the entire mailing community were engaged during the period in which the Postal Service first applied the rule at the class level. All participants were scrambling to figure out how to make as smooth a transition as possible from the PRA regime to the PAEA

³ The observation by Valpak of this phenomenon cited by ANM at page 13 occurred nearly a year later, in late January of 2009.

regime. The Mail Classification Schedule was still a work in progress. See Order No. 43, Docket No. RM2007-1 (Oct. 29, 2007) at 101-103. A very large number of questions regarding how the new ratemaking structure would actually operate in practice were still open, and what future adjustments might be made in the new regime were anyone's guess. Certainly no one had a crystal ball regarding future mail mix changes within the commercial and nonprofit components of the newly created Standard Mail products, or how those might affect various hypothetical approaches to the ratio calculation exercise. In the midst of these myriad endeavors, for this one discrete new conundrum, the Postal Service proposed the adoption of a straightforward approach that was simple to apply. The implicit suggestion by ANM that such action at that time and under those circumstances should forever foreclose a reevaluation of whether that approach can be improved within the parameters of the existing statutory provision does not withstand scrutiny.

ANM also challenges the practical impact of the discrepancy, but does so in a way that excludes the most relevant information. ANM, in effect, creates a strawman with the proclamation that the current approach has not "resulted in materially higher prices increases for commercial than for nonprofit Marketing Mail *since* R2008-1." ANM Comments at 15 (emphasis in original). To support this claim, ANM cites back to its own Table 1 on page 11 of its Comments. The trick, however, is that by framing its statement in terms of changes "*since* R2008-1," ANM manages to omit the critical first rate change that coincides with the switch from the previous (subclass) approach to current (overall class) approach, which is to say, the R2008-1 change itself. To appropriately explore the broader claim which ANM is attempting to postulate, it is

necessary to expand ANM's Table 1 to reflect all of the price changes under the current regime, including R2008-1:

Expanded ANM Table 1

Docket No.	% Change in Rates	
	Standard Mail Commercial	Standard Mail Nonprofit
	[a]	[b]
R2008-1	3.1%	0.7%
R2009-2	3.7%	4.5%
R2011-2	1.9%	0.5%
R2012-3	2.4%	-0.7%
R2013-1	2.4%	4.1%
R2013-10	1.6%	2.1%
R2015-4	1.8%	2.7%
R2016-2	0.0%	0.0%
R2016-5	0.0%	-0.1%
R2017-1	0.9%	1.2%
CUMULATIVE	19.0%	16.1%

Source: USPS.Reply.Cmmnts.Prop.8.Attach.xls,
USPS-RM2017-12/2

The narrative changes considerably. Now there is a material difference in the cumulative rate changes, of approximately 3 percentage points, which represents approximately 18 percent of the cumulative nonprofit increase. Contrary to what ANM argues on page 15, the reversal of the switch from subclass to class can be justified on the grounds that nonprofit mailers have been enjoying lower rates for the entire period beginning with the R2008-1 rate regime.

There are, of course, other measures by which to test the ANM claim on page 10 that the relationship between nonprofit and commercial rates has been “remarkably

stable” since the class ratio approach was adopted. Since the statutory provision was not intended to be framed directly on proportional rate increases (of the type explored in ANM’s Table 1 and above), but rather on proportional average revenues per piece, it is perhaps useful to compare the mail types in term of the revenue-per-piece metric.

Because ANM feels it appropriate to limit the focus to the period *since* the ratio calculation switch, the figures below provide some average revenue per piece comparisons between the last year before the switch, FY 2007, and the most recent year after the switch, FY 2016.

				FY 2007	FY 2016	Percent Change
Nonprofit, All Shapes						
Average Revenue per Piece				\$0.1309	\$0.1374	5.0%
Commercial, All Shapes						
Average Revenue per Piece				\$0.2112	\$0.2322	9.9%
Nonprofit Letters						
Average Revenue per Piece				\$0.1181	\$0.1186	0.4%
Commercial Letters						
Average Revenue per Piece				\$0.1892	\$0.2187	15.6%

Source: USPS.Reply.Cmmnts.Prop.8.Attach.xls, USPS-RM2017-12/2

Across all shapes (i.e., on an overall basis), the average revenue per piece for commercial mail has clearly grown more rapidly than the corresponding figure for nonprofit mail (at almost exactly double the rate), and the contrast is even more stark when limited to letter shape mail. One can hardly describe these relative changes as indicative of stability. The explanation, of course, is due to many factors, but mail mix emerges as a prominent one. The substantial influences that mail mix can have, as well

as some of the relevant trends across nonprofit and commercial mail, were discussed in the Appendix on page 8 of Proposal Eight. The question that arises, therefore, is whether there is a way to take mail mix changes out of the equation, or, more accurately stated, to take *relative* mail mix changes out of the equation. The answer is yes, using a metric that ANM itself discusses within its summary (Comment pages 3-10) of the background and history of the rate preferences within what is now known as USPS Marketing Mail.

As ANM describes the sequence of events when the 60 percent ratio was established in 2000, the intent of setting nonprofit average revenue per piece at 40 percent less than the average revenue per piece of the most closely corresponding commercial subclass was to attempt to approximately perpetuate the “effective discount” for nonprofit mail in the neighborhood of the then-current “effective discount” figure of 27 percent. ANM Comments at 7. The “effective discount” (or “rate preference” as it is referred to by ANM) can be calculated by holding the nonprofit mail mix constant (by weight, zone, presort level and other billing determinants) and deriving total revenue from such a mail mix by first applying a set of nonprofit rates, and then applying the corresponding commercial rates. The resulting percentage reduction in total revenue from applying the nonprofit rather than commercial rates constitutes the average “effective discount” for nonprofit mail at that point in time. Since the only mail mix involved in these calculations is the nonprofit mail mix, the commercial mail mix is irrelevant, and thus relative changes in mail mix between the two categories are not a factor when examining the “effective discount” for nonprofit mail over time.

As noted above, by ANM's account, the "effective discount" to which the 60 percent ratio was calibrated in 2000 was about 27 percent. ANM cites no source for that figure, and in the short time since the ANM comments were filed, the Postal Service has not been able to identify any corroboration of that figure. Instead, the Postal Service has conducted its own calculation of the "effective discount" for nonprofit mail in FY 2000, the last full year before the 60 percent ratio provision took effect. The result of that calculation is an FY 2000 "effective discount" of 36.3 percent.⁴ Since that time, however, the "effective discount" rate has increased quite substantially. Notably, the results of the same exercise using the nonprofit billing determinants and respective nonprofit and commercial rates from the most recent rate case, Docket No. R2017-1, yields an "effective discount" of 45.9 percent. Moreover, a healthy portion of that increase from 36.3 percent to 45.9 percent occurred in the period *after* the switch to the total class ratio method, as the corresponding "effective discount" in Docket No. R2006-1 (the omnibus rate case immediately prior to the switch) was 40.2 percent. Moreover, to put all of this in perspective, even if the nonprofit rates in R2017-1 had been uniformly and immediately increased by the *full* percentage amounts associated on page 5 of Proposal Eight with switching back to the subclass method – 3.33 percent for non-ECR mail and 6.94 percent for ECR mail (reflecting a 3.77 percent weighted average) – and the rates for each commercial subclass had been correspondingly decreased by the much smaller percentages indicated in Proposal Eight, the "effective discount" would still have fallen only to approximately 43.5 percent, well above the baseline figure from 2000. By the "effective discount" metric, the remarkable stability

⁴ The calculations supporting that result, and the others cited in this discussion, can be found in USPS-RM2017-12/2, filed in conjunction with these reply comments.

alleged by ANM in the relative rate relationships between nonprofit and commercial mail is plainly illusory.

Similarly, the ANM claim on page 10 that the rates enjoyed by nonprofit mailers since the switch from the subclass approach to the class approach in 2008 did not come at the expense of commercial mailers is not credible on its face. ANM readily concedes on page 2 that the class approach has tended to produce lower nonprofit rates than the subclass approach. Under the existing price cap regime, simple logic dictates that lower nonprofit rates will necessarily result in higher commercial rates. The attempt by ANM to gloss over this basic reality is unavailing.

Overall, ANM tries to paint a picture in which the *status quo* approach of calculating the 60 percent ratio at the class level has produced a very even-handed treatment of nonprofit and commercial mailers, and that Proposal Eight is simply an attempt by the Postal Service to suddenly tilt the balance to the unjustified detriment of the nonprofit mailers. See ANM Comments at 15-16. The true picture, however, is quite different. Congress presumably had something in mind in 2000 when they established the 60 percent ratio at the subclass level. As ANM acknowledges on pages 5-8, while everyone involved at that time realized that focusing the standard on average revenue-per-piece was employing a fairly blunt instrument, the basic idea was to create a framework in which the effective rate preferences for nonprofit Standard Mail would presumably remain in the same ballpark where they resided at that time. For any number of reasons, that expectation appears not to have been fulfilled, with the effective rate preference tilting significantly in favor of the nonprofit mailers in the intervening years.

Yet against that backdrop, Proposal Eight focuses solely on the subsequent choice made several years later, in the context of the uncertainty of the implementation of the new PAEA regime in early 2008, to switch from subclass calculations to a unified class calculation. The Postal Service is not disputing that such a choice might have made sense at the time. As a matter of pure theory, under any number of totally plausible circumstances (i.e., sets of alternative mail mixes), the results of the class approach might not differ all that much from the subclass approach, and the computational and administrative benefits for rate design are obvious. Of course, as an empirical matter, that turned out not to be the case – the results did differ. Whether, as ANM now insists, more attention should have been paid to those empirical details, at least as they were playing out at that time, is essentially beside the point. No one could have known whether what was true then would persist into the future, with the most obvious example being what happened to total mail volume in the years following implementation of the PAEA when the class-level choice was made.

Proposal Eight does not attempt to address the entire panoply of factors that, as AMN notes on page 7, everyone was aware could shift around going forward. Instead, the proposal simply presents the issue of whether the class/subclass choice made in 2008 should be revisited based on current circumstances and, as the Postal Service requests, be reversed for purposes of future application. Such a course of action is fully consistent with applicable administrative law:

An agency is free to discard precedents or practices it no longer believes correct. Indeed we expect that any agency may well change its past practices with advances in knowledge in its given field or as its relevant experience and expertise expands. If an agency decides to change course, however, we require it to supply a reasoned analysis indicating

that prior policies and standards are being deliberately changed, not casually ignored.

Nuclear Energy Inst., Inc. v. EPA, 373 F.3d 1251, 1296 (D.C. Cir. 2004) (per curiam) (citations omitted). In this instance, the relevant experience is encapsulated in Table 1 on page 3 of Proposal Eight (and confirmed by the same information in Table 2 on page 14 of the ANM Comments), which shows an unmistakable downward shift in the Total class ratio (the last column) occurring in 2008 and persisting throughout the years since. ANM does not dispute that this shift can be attributed to the switch at that time from the subclass approach specified in the statute to the class approach, or contend that there is any reason to expect that the effects of the switch will naturally reverse over time without a methodological change. A reasoned basis to approve Proposal Eight has clearly been established. Compared with the original intent of Congress when establishing the ratio at 60 percent based on the subclass approach, the current methodology has not resulted in an even-handed treatment of nonprofit and commercial mailers.

Other grounds advanced by ANM to oppose Proposal Eight do not withstand scrutiny. For example, ANM vaguely mentions court cases to the effect that agencies considering a change in approach need to take into account “serious reliance interests” engendered by the existing approach. ANM Comments at 13. Yet, understandably, ANM makes no attempt to identify any major actions taken by nonprofit mailers in reliance on the class method that would be jeopardized by reversion to the subclass method. There are none. Like any rate increase, somewhat higher nonprofit rates triggered by Proposal Eight might cause nonprofit mailers to scale back on the volume of their mailings, but would not pose any regulatory threat to general continuation of

their mailing activities. Higher mail volumes (associated with current rates that are lower than would otherwise be the case) that can readily be curtailed in response to modest rate increases with sufficient advance notice do not fall within the examples of “serious reliance interests” envisioned as possible impediments to a regulatory change in course.⁵

Equally flawed is the attempt by ANM to portray Proposal Eight as contrary to “one of the fundamental policies of the 2000 legislation: to protect nonprofit mailers from unpredictable rate fluctuations.” ANM Comments at 15-16. First of all, as ANM itself makes clear earlier in its comments, the 2000 legislation was aimed at curbing preferred rate fluctuations occurring under the 1993 structure that were not just “unpredictable,” but were also “wide” and “large.” *Id.* at 5, 8. What the legislative history quoted by ANM on page 8 referred to generically as “significant rate swings” were actually quantified in discussions within the Commission’s Recommended Decisions in Docket Nos. R97-1 and R2000-1. In Docket No. R97-1, the Postal Service sought an overall increase for the Nonprofit (non-ECR) subclass of 11.3 percent, with a requested increase for Nonprofit Letters of 19 percent (compared with a corresponding decrease for the Regular letter rates of 3.5 percent). PRC Opinion and Recommended Decision, Docket No. R97-1 (May 11, 1998), Vol. 1 at 458, 460. The average increase actually

⁵ The Postal Service, of course, is not seeking to unduly minimize the budget consequences for very worthy nonprofit organizations that might, for example, be required to trim the least remunerative names and addresses from their mailing lists, or to reduce the number of mailings sent each year. But such consequences would militate against any increase in nonprofit rates, regardless of the basis, and the intent of the current rate preference scheme was certainly not to lock in nonprofit rates at current levels forever. As discussed above, even under Proposal Eight, nonprofit mailers seem likely to continue to receive an “effective discount” greater than what they received at the time of the adoption of the 60 percent ratio.

recommended by the Commission for the Nonprofit subclass was 9.6 percent. *Id.* at 469. In contrast, the requested *decrease* for Nonprofit ECR was 6.3 percent, and the actual Commission recommended average *decrease* for Nonprofit ECR was 10.4 percent. *Id.* at 473. Three years later, the situation in the next case was even worse. Applying the RFRA formula to Nonprofit ECR would have resulted in a rate increase of over 30 percent. PRC Opinion and Recommended Decision, Docket No. R2000-1 (November 13, 2000), Vol. 1 at 397. Clearly, the percentage increases contemplated in association with the instant Proposal Eight, in the three to seven percent range (with a weighted average of 3.77 percent), are nowhere near the magnitudes that actually triggered the 2000 legislation, and to insist that they would intrinsically violate a fundamental principle of that legislation is not credible.

Second, not only are the contemplated Proposal Eight rate increases smaller by an order of magnitude than some of the “significant rate swings” that the 2000 legislation was intended to curb, but they also represent a one-time transitional adjustment. In reality, the switch from the subclass method to the class method in 2008 created a level-shift that benefitted nonprofit mailers.⁶ Switching back now would merely create an offsetting level-shift in the other direction. That level-shift would be entirely predictable, and once the transition were completed, there is absolutely no basis to suggest that continued application of the subclass method would create any greater instability on a year-to-year basis going forward than the class method.

Moreover, the Postal Service has made it perfectly clear that it would endeavor to spread the impact of the resulting one-time level-shift over more than one CPI rate

⁶ At that time, of course, neither ANM nor any nonprofit mailers complained about the consequences of this “rate fluctuation” that accrued to their benefit.

adjustment cycle. Proposal Eight at 5-6. ANM's only response, that the Postal Service does not identify any statutory basis for such mitigation efforts (Comments at 16-17), is factually incorrect. The Postal Service explicitly cited the "as nearly as practicable" language within section 3626(a)(6)(A). *Id.* It is ironic that ANM would view the provisions of section 3626(a)(6) as sufficiently flexible to allow nonprofit mailers to continue indefinitely to accrue the full benefits of calculating the ratio at the class level despite the statutory specification of "subclass," but not sufficiently flexible to allow the windfall benefits of the class level approach to be phased out gradually.

Conclusion

To be sure, in advancing Proposal Eight, the Postal Service is requesting that the Commission depart from current practice. But the Commission is free to depart from past precedents if there is good reason to do so. A passage from a case cited by ANM on page 12 of its Comments very aptly summarizes the current circumstances:

[T]he agency must show that there are good reasons for the new policy. But it need not demonstrate to a court's satisfaction that the reasons for the new policy are *better* than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency *believes* it to be better, which the conscious change of course adequately indicates.

FCC v. Fox Television Stations, Inc., 556 U.S. 502, 515 (2009) (emphasis in original).

The Postal Service believes that, in hindsight, and with consideration of the actual relative mail mixes of nonprofit and commercial mail that have been experienced over the last decade and a half, that are seen today, and that seem likely to continue in the future, the subclass method is the better method to compare revenue per piece ratios. As explained above, the Postal Service is convinced that the subclass method more

faithfully achieves the intent of the 60 percent provision when enacted in 2000.

Proposal Eight would allow the Commission to embrace those conclusions as well.

Respectfully submitted,

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